No. 21834 and No. 21834-A

In the

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

WEYERHAESER COMPANY,
Appellant and *Cross-Appellee*

vs.

UNITED STATES OF AMERICA,
Appellee and *Cross-Appellant.*

ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON

REPLY OF WEYERHAEUSER COMPANY AS APPELLANT and ANSWER OF WEYERHAEUSER COMPANY AS CROSS-APPELLEE

FILED

MAR 1 1968

WM. B. LUCK, CLERK

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I. TAXPAYER AND GOVERNMENT ARE IN AGREEMENT ON MAJOR POINTS

The Government's answering brief contains a single thesis. It asserts that the "contractual relations here provided for the pooling of logs" instead of the "contract right to cut timber" required by § 631(a) (Govt. Br. 3-4). The purpose of this reply is to demonstrate the error in that thesis, after first briefly noting the major points on which taxpayer and Government agree.

A. Taxpayer and Government Agree That No Other Party Can Claim the § 631(a) Benefits In Issue

The Government has volunteered that Mountain Tree Farm Company cannot claim the § 631(a) benefits in issue (Br. 9):

> "Of course, Mountain Tree, the logger, was not given a 'contract right to cut' qualifying it for § 631 benefits since it had no unlimited right to dispose of the cut timber. *Cf. Carlen v. Commissioner,* 220 F. 2d 338 (C.A. 9th); *United States v. Johnson,* 257 F. 2d 530 (C.A. 9th)."

The Government has thus implicitly also acknowledged that Scott cannot claim a contract right to cut *taxpayer's half* of the Watershed timber because Scott also "had no unlimited right to dispose of the cut timber." Scott divested itself of that right in the formation of the 1946 venture by granting taxpayer a right to a *full one-half* of the Watershed timber regardless of the source of the cut (Taxpayer's Opening Br. 28-29). Thus, the Government makes no pretense

of championing Scott's cause.[1] At the same time the Government has acquiesced in our statement that the loss of the benefits by both taxpayer and Scott would mean a windfall to the Government resulting from the taxpayer-Scott effort to accommodate the public interest in the Watershed (Taxpayer Br. 36-37). While the Government has declined to expressly admit that it seeks a windfall, its attack on taxpayer's position, without corresponding support of Scott's position, obviously amounts to the same thing.

B. Taxpayer and Government Agree That Taxpayer Is Exclusively Vested With the Proprietary Interest Essential to a § 631(a) Claim

The Commissioner and this Court have declared a proprietary interest in timber requisite to § 631(a) benefits and defined such an interest as "an unrestricted right to sell the logs for the taxpayer's own account or to use them in the taxpayer's trade or business" (Taxpayer's Br. 15-17). The parties are agreed that, as a result of the taxpayer-Scott venture, taxpayer acquired an unrestricted right to sell, or use in its business, half of the Watershed harvest (Pret. Ord. ¶ 2(h), Record 6-7). It was in response to Seattle's requirement of a single logging operation in the Watershed that taxpayer and Scott united their Watershed timber in a venture under which they shared

[1]The Government has further conceded (by failing to challenge) taxpayer's contention that awarding Scott § 631(a) benefits arising from gains realized by taxpayer from taxpayer's half of the Watershed timber would grossly distort the taxable income of both taxpayer and Scott (Taxpayer's Br. 29-35). Finally, the Government has acquiesced in taxpayer's contention that Scott cannot be considered to have cut taxpayer's half of the Watershed timber (Taxpayer's Br. 29).

equally not only in the timber harvest, but in contributions, risks, control and gains as well. (Taxpayer's Br. 15-22). Since the contributions were made at 1946 stumpage prices of $1 - $7 per thousand, the gains derived by the venture accrued from appreciation of the timber over the 1946 prices. Such gains of the venture produced § 631(a) capital gain benefits under the formula contained in that statute (Taxpayer's Br. 19). We contended that just as gains of the venture were shared equally, so should the § 631(a) benefits arising from the venture's gains be shared equally. To summarize, *the § 631(a) benefits claimed by taxpayer are solely those arising from timber appreciation realized by taxpayer from exercise of its undisputed right to use or sell half of the Watershed harvest.* In fact, the Government has conceded (Br. 11):

> ". . . that the agreements ultimately enabled it [taxpayer] to profit from appreciation in Scott's timber . . . . "

Thus the Government concedes *taxpayer's right to the gains producing the § 631(a) benefits here in issue.*

It is apparent from the Government's concessions that this Court's task is not one of contract *construction.* Rather, it is one of contract *characterization.* In short, the parties do not seek the assistance of this Court to ascertain whether taxpayer has the right to the financial benefit of the post-1946 appreciation which produced the § 631 benefits in issue because the Government *concedes* that taxpayer has the right to the financial benefit of such appreciation. Rather, the Government's brief asks only that this Court characterize that right for tax purposes. Was it a right to

"cut timber," as taxpayer contends, or was it merely a right to share in a "pooling of logs" as the Government contends? We believe we can provide a clear and convincing answer to that question. After we have done so, we will point out the errors we see in the Government's answer to the question.

II. TAXPAYER'S PROPRIETARY RIGHT SHOULD BE CHARACTERIZED AS A RIGHT IN "TIMBER" NOT "LOGS"

We ask the Court to observe that taxpayer has undisputedly met every burden heretofore imposed upon § 631(a) litigants, i.e., taxpayer has proved its unrestricted right to sell the timber for its own account or use it in its business and to realize the timber appreciation which triggers the operation of § 631(a). Yet the Government says that taxpayer should not prevail because its interest was in "logs" rather than in "timber." Although one ends up with wood fiber whether he has rights in "timber" or in "logs," the Government's assertion implies that there is a meaningful distinction between the two interests. The Government does not say what the distinction is. We must begin our analysis by identifying it.

It seems likely that the physical distinction between "timber" and "logs" is one upon which taxpayer and Government can readily agree. When asserting that taxpayer's interest was in "logs," the Government no doubt intends to say that such interest was in *felled* trees. By contrast, the Government presumably understands the term "timber" as used in § 631(a) to mean *standing* trees.

A businessman will immediately see that, arising out of the physical difference between "timber" and "logs," there is an economic difference of great importance. He will see that an interest in standing timber requires a cutting or logging operation with all its opportunities, risks and responsibilities. He will further see that, to avoid the risks and responsibilities of a logging operation by purchasing "logs," one must buy at the higher prices effective in the "log" market rather than at the lower "stumpage" prices effective for timber still on the stump. Obviously, the higher cost of logs reflects the expense involved in converting timber into logs by felling the timber, bucking the logs and moving them to the dump. The economic lesson for the businessman is clear. He may pay a "stumpage" price for timber on the stump and bear the risks and responsibilities of the logging operation, or pay a "log" price for logs in the dump or pond. But he cannot afford *both* to bear the risks and responsibilities of logging *and* pay a "log" price. If his contract requires him to bear the risks and responsibilities of logging, economic logic drives him inexorably to the conclusion that he must pay no more than a "stumpage" price for standing timber. The opposite side of the same economic coin is that the timber owner who receives no more than a "stumpage" price must insist that his purchaser bear the risks and responsibilities of the logging operation.

We will demonstrate that taxpayer's interest was in "timber" and not in "logs" because (i) taxpayer paid a "stumpage" price rather than the higher "log"

price, and (ii) the contracts placed upon taxpayer the opportunities, risks and responsibilities of the logging operation.

A. Taxpayer Paid a "Stumpage" Price for Standing Timber, Not the Higher "Log" Price

Assume a year in which the *entire* Watershed harvest is from Scott timber. Taxpayer would be obliged to pay Scott for taxpayer's entire half of the Watershed harvest under the provisions of ¶ II (b) of Exhibit 2.[2] That is, in a year when nothing is harvested from taxpayer's timber, taxpayer (as the "company from whose timber the lesser total value was produced") must pay to Scott (as the "company from whose timber the greater value was produced") half of the value produced. Note that the payments are termed "stumpage" and "stumpage prices":

> ". . . 'Stumpage' has a well defined legal meaning. It means standing timber." *Giustiana v. United States,* 190 F. Supp. 303, 313 (D.C. Ore. 1960).

Contrast the above "stumpage" payment provision of ¶ II(b), under which taxpayer paid for its half of the Watershed timber, with the provision for a "log" purchase contained in ¶¶ II(c) and (d) of Exhibit 2.

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[2] "(b) The stumpage to be paid by one company to the other from time to time shall be determined as follows: . . . the following prices shall be applied to the quantities of logs, hemlock pulpwood, . . . removed and delivered from the timber of each of the parties during the preceding year: (1) the zone stumpage prices for logs prescribed in Exhibit A hereto, (2) the price of fifty (50c) cents per cord of 128 cubic feet for hemlock pulpwood . . . . The difference in total prices, as so determined, shall be computed and one-half thereof shall be forthwith paid by the company from whose timber the lesser total value was produced during said year to the company from whose timber the greater value was produced. . . ."

The latter provision, while acknowledging that each party has a right to half the harvest from the Watershed each year regardless of the source of the harvest, recognizes the practical impossibility of precisely equal deliveries. For example, assume, again in a year where the entire harvest is from Scott timber, that Scott inadvertently receives 1,000 B.F. of timber in excess of its half share. Under the "stumpage" payment provision of ¶ II(b) discussed above, taxpayer would, nonetheless, be obliged to pay Scott for exactly half the Watershed harvest. In other words, taxpayer would pay Scott up to $7 for the 1,000 BF inadvertently delivered to Scott as an excess over Scott's rightful half share. However, under ¶ II(c) Scott is required to pay taxpayer the current Puget Sound "log" price for the 1,000 BF erroneously delivered to Scott.[3]

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[3]"(c) It has been agreed herein and in the logging contract that the Timber Companies shall each receive one-half of all logs of each species produced from the timber of both companies, but it is recognized that the deliveries of various grades of logs cannot and will not remain equal from time to time. It is therefore agreed that deliveries of each grade of each species of logs shall be kept as nearly equal as possible between the two companies at all times, but that within ten days following the end of the calendar year hereafter the parties hereto will determine the quantity of logs of each grade and species delivered to each of them during the preceding calendar year and the company which shall have received an excess in value of logs during said year on account of differences in grades shall pay to the other company an amount equal to one-half of such excess value. The quantities of logs so delivered shall be determined, in the absence of clear mistake, on the basis of the reports to be made in accordance with Article V of the logging contract, and the value of each grade of logs of each species shall, for the purposes of this paragraph (c), be deemed to be the market price, at the time of delivery hereunder, for like logs delivered in Puget Sound waters and scaled, rafted, and ready for towing; provided, however, . . . if it shall reasonably appear that there is no longer a reliable market valuation on Puget Sound for logs of such grade or grades, then the valuation therefor on the Columbia River shall thereafter apply; and provided further, . . . if it reasonably appears that there is no longer a

In other words, the substance of ¶¶ II(b), (c) and (d), taken together, is that taxpayer purchases "stumpage" from Scott at up to $7 per M and [after bearing the costs and responsibilities of the logging operation (Taxpayer's Br. 25-26)] sells to Scott the resulting "logs" inadvertently delivered to Scott, at the Puget Sound "log" price. Assuming a Puget Sound log price of $80 per M, and a logging expense of $30 per M, the result would be:

Puget Sound Log Price Paid by Scott to Taxpayer		$80.00
Stumpage Paid by Taxpayer to Scott	$ 7.00	
Logging Expense Borne by Taxpayer	30.00	
Total Cost to Taxpayer.		37.00
GAIN TO TAXPAYER BY SELLING LOGS FROM SCOTT TIMBER TO SCOTT.		$43.00

The importance of ¶¶ II(c) and (d) is that they represent a painstaking description by taxpayer and Scott of a "log" sale. They prove conclusively that when the parties wanted to describe a "log" sale they knew exactly how to do so. Note the exacting effort of the parties to establish log prices which would truly reflect log market values, complete with references to the Puget Sound "log" market and the alternative

reliable market valuation for such grade or grades of logs on either Puget Sound or the Columbia River, then the parties shall exert their best efforts to agree upon a valuation for such grade or grades, giving consideration, among other things, to the relative values of such grade or grades of logs and logs of other grades and species with respect to which there is an open market . . . .

"(d) If the parties should be unable to agree upon whether an open market for any grade or grades of logs exists on Puget Sound or the Columbia River, or upon a valuation for any grade or grades of logs, then the matter in controversy shall be settled by arbitration . . . ."

Columbia River "log" market. Note further the provisions for attempts at agreement on log market values in the absence of reliable Puget Sound or Columbia River markets, and failing agreement, the provision for arbitration.

Contrast all this with the brief, simple provisions of ¶ II(b) which stipulate *fixed* "stumpage" prices. *It was under ¶ II(b) that Taxpayer acquired its half of the harvest from Scott lands.* We submit that if the parties had intended taxpayer's acquisition from Scott to be a purchase of "logs," they would have framed the acquisition in the far more detailed and complex language of ¶¶ II(c) and (d). Since the parties obviously knew how to describe a log purchase, when they intended one, their express designation of Weyerhaeuser's purchase from Scott as a "stumpage" purchase must be considered intentional.[4]

B. Taxpayer Had the Opportunities, Risks and Responsibilities of the Logging Operation

Because taxpayer paid only a "stumpage" price, it is to be expected that the contracts would place upon taxpayer the risks and responsibilities (and the opportunities) of the logging operation respecting taxpayer's half of the Watershed harvest. We so demonstrated in our opening brief (Taxpayer's Br. 22-27). While the timber was necessarily felled by real woods-

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[4]There is a noteworthy parallel between the instant case and a leading § 631(a) case decided by this Court, *United States v. Johnson*, 257 F. 2d 530 (9th Cir. 1958). In that case a partnership acquired a contract right to cut timber from a timber company. As this Court described the contract provisions: (p. 532)

> "Under this contract, the partnership was granted the right and license to enter upon the described lands and remove all merchant-

men, such woodsmen (as the trial court implicitly recognized) cannot be considered to have "cut" the timber within the meaning of § 631(a) because they were mere wage earners who received no benefit from the cutting (aside from wages), assumed no risk, and exercised no control. Likewise, Mountain Tree Farm Company was a mere wage earner receiving no benefit from the cutting except its wages, assuming no risk under its cost-plus-fixed-compensation arrangement, and having no right of control over the harvesting of the Watershed timber. *The opportunities, risks and responsibilities of the logging operation rested, one-half upon taxpayer and one-half upon Scott* (Taxpayer's Br. 23-27). Accordingly, under the Commissioner's rules [reflected in this Court's decision in *Achong v. Commissioner,* 246 F. 2d 445 (9th Cir. 1957), and the excerpts from the Commissioner's brief in *H-H Ranch, Inc., v. Commissioner,* 357 F. 2d 885 (7th Cir. 1966), contained in Appendix B of our opening brief] the cutting of taxpayer's half of the Watershed timber must be imputed, for tax purposes, to taxpayer. Any serious attempt to deny that the cutting of taxpayer's half of the Watershed timber

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able timber, under the terms and conditions specified in the agreement.

"The partnership agreed to pay the timber company stumpage payments for all timber in the contract . . . .

". . . The timber company agreed to purchase from the partnership, 'at current market prices,' 'all logs logged' by the partnership from the described lands. . . ."

Thus, except that the sale back to the timber owner in *Johnson* was intentional rather than inadvertent, it is a parallel example of a holder of a contract right to cut acquiring standing "timber" at "stumpage" rates contained in a schedule and selling the resulting "logs" back to the timber owner at "current market prices."

should be imputed to taxpayer would require an attack on the very rules of law which the Commissioner has labored to establish in *Achong* and *H-H Ranch, supra.*

The Government has compromised. While defending on the issue, it has not challenged our analysis based on *Achong* and *H-H Ranch*. It has carefully refrained from attacking our demonstration that the contracts placed on taxpayer the opportunities, risks and responsibilities of the cutting. The Government thus destroys the plausibility of its thesis that taxpayer has an interest in "logs." If, as the Government admits, taxpayer has the opportunities, risks and responsibilities of logging, it cannot, as the Government asserts, have an interest in logs. Logging is an operation which must be performed upon *timber*. Thus, *Achong* and *H-H Ranch* tell us what common sense tells the businessman—the person who has the opportunities, risks and responsibilities of the logging operation has an interest in standing "timber," not felled "logs." [5]

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[5]While not attacking our analysis, the Government did make a brief collateral attack on our conclusion in an argument consisting of four sentences at p. 9 of its brief. It asserted that the control of Mountain by Taxpayer and Scott does not establish that Mountain was acting for them when cutting timber because ¶ VI of the logging contract (Exhibit 3) expressly negates that Mountain was the "agent" for either party. The same argument was the sole rationale of the Trial Court (aside from noticing that the taxpayer has the burden of proving the Commissioner in error by a preponderance of the evidence) in its initial Memorandum Order (R. 14). We then pointed out to the Court that "agent" is a label for a chameleon concept covering an infinite number of legal relationships. A corporation (being just a legal entity) can do nothing by itself. It cannot act except through the agency of real people, so it will have as many different "agency" relationships as it has different tasks to perform. For example, the "agency" relationship

III. THE GOVERNMENT'S ARGUMENTS CONTAIN READILY DISCERNIBLE ERROR

Since the Government has been unwilling to make a direct attack on the analysis contained in our opening brief it has been obliged to resort to a plethora of briefly stated arguments. We will point out as succinctly as we can the error we see in these arguments.

After stating its thesis that taxpayer acquired only a share in a "pooling of logs" the Government proceeds to its lead-off argument which seems to be, in substance, that had taxpayer *intended* to obtain § 631 benefits it could have easily drafted for this result

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of a corporation with a truck driver that it employs is likely to result in the imputation to the corporation of the torts committed by the driver with his truck in the course of his employment; but it is unlikely that the driver can commit the corporation to a million dollar contract with a third party. Conversely, the "agency" relationship that the corporation has with an independent broker makes it unlikely that torts committed by the broker with his automobile while on corporate business will be imputed to the corporation; but the broker may nevertheless be an "agent" in the sense that his commitments respecting a million dollar contract may be imputed to the corporation. Other persons may have the authority to solicit orders for the corporation, but not to accept them, or to make representations of fact which are binding on the corporation, but not to make promises, or to make certain promises but not to make other promises. In short, a corporation may tailor its "agency" relationships to its need. It may create one relationship while expressly denying the existence of others. Taxpayer and Scott employed a standard agency denial in the hope that Mountain's torts would not be imputed to them. Such denials may be ineffective even for their intended purposes. *Restatement, Agency* (2d), § 220(2)(i), Comment *m; Mueller v. Cities Service Oil Co.*, 339 F. 2d 303 (7th Cir. 1964). See also *Matcovich v. Anglim,* 134 F. 2d 834 (9th Cir. 1943); *Ringling Bros.-Barnum & Bailey Combined Shows, Inc. v. Higgins*, 189 F. 2d 865 (2d Cir. 1951). In any case, a hope that torts will not be imputed does not answer the question as to whether logging should be imputed to a taxpayer for income tax purposes. Ultimately, the Trial Court agreed and in his Order Denying Motion for Reconsideration expressly withdrew reliance upon the agency denial contained in Exhibit 3 (R. 18). Indicative of the Government's lack of plausible alternatives is its resurrection of an argument which the Trial Court considered unfit even as a make-weight argument.

(Govt. Br. 4-5). Observing that the contracts do not give the taxpayer a right "itself" to enter on Scott's land and cut timber, the Government infers an *intent not to obtain § 631(a) benefits* from taxpayer's failure to draft for such a right. This inference utterly ignores the fact that such a right in taxpayer and Scott would have defeated Seattle's objective to have a *single* logger in its Watershed. It is surely illogical to impute an intent to forfeit § 631(a) benefits from an action necessary to accommodate the public interest.

The Government purports to see further evidence of an intent to forfeit § 631(a) benefits based on its conclusion that in the State of Washington the proper way to acquire a right to cut is by "formal deed." (Govt. Br. 5-6). It argues that if taxpayer and Scott "had intended to convey interests in timber it seems they would have used documents proper for that purpose." The fallaciousness of the Government's inference of intent is revealed by the fact that *not a single case we have found arising out of the State of Washington in which this Court, the Tax Court, and the District Court for the Western District of Washington have sustained § 631(a) benefits, has involved a formal deed*! On the contrary, all have involved contracts not meeting the formalities appropriate to deeds. *United States v. Johnson,* 257 F. 2d 530 (9th Cir. 1958); *Pinkerton v. Commissioner,* 28 T.C. 910, *acquiescence* 1958-1 Cum. Bull. 5; *Wirkkala v. United States,* 181 F. Supp. 338 (W.D. Wash. 1960). See also *Hitchcock v. Frank,* decided May 3, 1963, 63-1 USTC

¶ 9497 (W.D. Wash.)[6] The Government's error lies in its failure to distinguish between one who claims under § 631 as an "owner" and one who merely claims, as does taxpayer, a "contract right to cut." Note that the Commissioner himself has contemplated that the requisite "contract right to cut" can be created (Rev. Rul. 58-295, 1958-1 Cum. Bull. 249 at 250):

> " . . . Where a taxpayer is granted a *contractual right* to cut and remove all or a described part of the merchantable timber on a particular tract of land . . . ." (Emphasis supplied)

Moreover, it has been settled law in Washington State since 1893 that, notwithstanding Washington's deed statutes, an executory contract for the sale of standing timber is valid when in writing although not in the form of a deed. *Kleeb v. Bard,* 7 Wash. 41, 34 Pac. 138 (1893).[7] The rule is the same with respect to con-

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[6]The unanimity of the cases arising out of the State of Washington suggests the scope of the disaster to taxpayers if the Government were to succeed, this late in the day, in drawing negative inferences from the absence of formal deeds in cases involving contract rights to cut. Decisions arising out of other states also seem to be unanimous in approving contracts. *Gilmore v. United States,* 180 F. Supp. 354 (Ct. Cl. 1960); *Carpenter v. Commissioner,* 36 T.C. 797 (1961), *acquiescence* 1962-1 Cum. Bull. 3; *Lansing v. Commissioner,* TC Mem. 1964-82 Filed Mar. 30, 1964, 23 CCH Tax Ct. Mem. 498; *Shaffer v. Commissioner,* TC Mem. 1960-186, filed Sept. 12, 1960, 19 CCH Tax Ct. Mem. 978.

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[7]The court reasoned (at p. 44): ". . . As to the Perry tract, conceding that an executory contract to sell standing timber to be cut and removed by the purchaser is a contract for the sale of an interest in land, and therefore within the statute of frauds (1 Warv., Vend., p. 175; *Owens v. Lewis,* 46 Ind. 488), still we are unable to see why the contract which respondent held from the Perrys did not meet this requirement. True, it was not a deed, but it is not necessary that a contract to sell land, as such, be a deed. The terms of this instrument showed that it was intended to be merely a license to occupy the land for such time and in such manner as should be required to remove the mer-

tracts for the sale of land itself. The application of the deed statutes has long been confined to conveyances of legal title and encumbrances. *Anderson v. Wallace Lumber & Mfg. Co.,* 30 Wash. 147, 70 Pac. 247 (1902); *Phillipp v. Curtis,* 35 Wn. 2d 844, 215 P. 2d 431 (1950).[8] The cases included in the Government's brief, as well as other Washington cases referring to the deed statutes, either approve timber conveyances which were in fact made by deed[9] or concern the question as to whether timber conveyed separately from the land be·

chantable timber therefrom, with the right to take the timber at fifty cents per thousand feet, to build and operate a sawmill, to use the water privileges on the land in connection with the mill, and to remove the mill after the timber had beeen manufactured. Neither the land, nor any interest in the land as land, was contemplated; but the timber was the principal subject matter of the contract, to which all the other uses to which the land might be put were incidents. Nothing in this contract created any exclusive right in the grantee to occupy the tract. On the contrary, both parties to it might have been exercising dominion over the whole of it at the same time, the Perrys in every way not inconsistent with the prosecution of the lumbering business by the respondent, and the latter in every way necessary to his business. These considerations, it seems to us, take such cases out of the purview of Gen. Stat., § 1422, which prescribes that conveyances of lands or interests therein shall be by deed. . . ."

[8]Consequently, the difference between the interests of a land contract vendee and a deed grantee is reduced to a quibble. The contract vendee has merely to ask a court to compel the deliverance of a deed. Furthermore, when the deed is delivered, it will be binding between the parties although it inadvertently omits the formality of an acknowledgment. *Ockfen v. Ockfen,* 35 Wn. 2d 439, 213 P. 2d 614 (1950). The timber contract holder has no need even to compel the delivery of a deed since he can obtain title to the timber simply by exercising his license to sever and remove it. *Kleeb v. Bard, supra.*

[9]*Coleman v. Layman* (cited by the Government), 41 Wn. 2d 753, 252 P. 2d 244 (1953), involved a timber deed and the court merely noted in passing that growing timber can properly be conveyed separately from the land by deed.

comes personalty or remains realty[10] or involve questions about oral contracts.[11]

The Government next professes to glean an intent of the parties to deal in "logs" from the way in which they used the terms "logs" and "timber" in the contracts (Govt. Br. 6-8). In fact, the parties used the term "timber" when referring to trees still standing and the term "logs" when referring to trees which had been felled. Such usage is common everywhere. The error of the Government's inference from such usage can be readily demonstrated. First, consider the language that the Commissioner himself has used in defining a "contract right to cut" (Rev. Rul. 58-295, *supra*):

> ". . . Where a taxpayer is granted a contracautal right to cut and remove all or a described part of the merchantable *timber* on a particular tract of land he has a proprietary interest in the *timber* cut by him if at the time of the cutting he has an unrestricted right to sell the *logs* or use them in his trade or business." (Emphasis added)

Thus, in the course of a *legal definition* of a "contract right to cut" the Commissioner considers it perfectly

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[10]This was the issue in *Elmonte Inv. Co. v. Schafer Bros. Logging Co.*, 192 Wash. 1, 22, 72 P. 2d 311 (1937), which was included in the quoted material from the Government's brief. The issue is a confused one in Washington because the Washington court has seemingly twice reversed itself on the issue, the second time without acknowledging that it was doing so. See Johnson, *Washington Timber Deeds and Contracts*, 32 Wash. L. Rev. 30 (1957), and *Leuthold v. Davis*, 56 Wn. 2d 710, 355 P. 2d 6 (1960).

[11]In *Groeneveld v. Dean*, 40 Wn. 2d 109, 241 P. 2d. 443 (1952), also cited by the Government, the court simply sustained the lower court finding that no oral contract was proved so that it was unnecessary to consider whether there had been a part performance sufficient to remove it from the statute.

proper to apply the word "timber" only to trees still standing and to change to the word "logs" when referring to trees which have been felled. A further refutation of the Government's inference is contained in the contract itself, namely ¶ II(b) of Exhibit 2, which fixes the price that taxpayer must pay Scott for taxpayer's half of the Watershed timber derived from Scott's land.[12] The payments taxpayer is to make are termed "stumpage" and "stumpage prices." "Stumpage," as we have seen, has a well defined legal meaning as "standing timber." *Giustina v. United States, supra.* Note further that although the payment provision refers to "stumpage," i.e., payment for *standing timber,* the parties consistently described the trees purchased as "timber" when standing, and as "logs" when felled. Thus, the usage of the parties was consistent with that employed by the Commissioner in his definition of a "contract right to cut" within § 631(a).

Finally, the Government has noted "substantial incidents of ownership which each party retained in its

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[12] "The *stumpage* to be paid by one company to the other from time to time shall be determined as follows: Within ten (10) days after the close of each calendar year the following prices shall be applied to the quantities of *logs*, hemlock *pulpwood*, and forest products other than said *logs* and *pulpwood*, removed and delivered from the *timber* of each of the parties hereto during the preceding calendar year: (1) the zone *stumpage* prices for *logs* prescribed in Exhibit A hereto, (2) the price of fifty (50c) cents per cord of 128 cubic feet for hemlock *pulpwood*, and (3) the agreed price or prices, under paragraph II(a) above, for forest products other than *logs* and hemlock *pulpwood*. . . ." (Emphasis supplied)

The Court will observe that in *all* cases where § 631(a) benefits have been approved for holders of contracts to cut "timber," the volume of timber has been ascertained by measuring *after* felling, which is the only pactical way to do it. Hence, the references in the contracts to quantities and prices of "logs."

own timber" including "title," "risk of damage and of destruction" and the obligation to pay "property taxes and charges for fire protection" (Govt. Br. 8-9). What the Government has overlooked is that taxpayer need not claim as an "owner" under § 631(a), but merely as the holder of a contract right to cut. Both this Court and the Tax Court have termed similar contract provisions as "boilerplate" not necessarily inconsistent with the possession of a contract right to cut within § 631(a). *United States v. Johnson*, 257 F. 2d 530, 534 (9th Cir. 1958); *Shaffer v. Commissioner*, T.C. Mem. 1960-186, filed Sept. 12, 1960, 19 T.C.M. 978, 985. Moreover, the Government's argument is predicated on an erroneous or incomplete understanding of the risk of loss and property tax provisions.[13]

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[13]It is not true that "each party retained the risk of damage and of destruction of its own timber by fire or other causes." Such losses of the Watershed venture are shared equally between taxpayer and Scott. The provision of ¶ IV of Exhibit 2 that each party will assume the risk of casualty losses to its own timber is not an exception to equal sharing of losses, because it can affect only appreciation in the timber accruing *prior* to the formation of the venture in 1946. Loss of the appreciation accruing in the timber during the life of the venture is necessarily shared equally by the parties by reason of their equal sharing of the harvest. In other words, if all Scott timber should be destroyed, Scott loses the \$1-\$7 per thousand at which the timber is to be contributed to the venture, but taxpayer and Scott are equal losers of the gains they would have shared from the timber's appreciation over the 1946 stumpage prices. And it is the post-1946 appreciation which produced the § 631(a) benefits here in issue.

Likewise, the Government has not understood the provision respecting payment of property taxes and charges for fire protection. It is true that each party pays such taxes and charges on its own timber for the period ending 1970 during which both parties were expected to have timber still standing. It is apparent that the parties believed that, while both had timber still standing, such a procedure would be easier and productive of roughly the same result as if they had made reciprocal contributions to each other for taxes and fire charges. After 1970, however when it was contemplated that all taxpayer's timber might have been cut, the contract requires taxpayer to pay a full one-half of the taxes and charges respecting Scott's timber.

The balance of the Government's brief simply anticipates, and attempts to rebut, the arguments which have been made in the earlier sections of this brief.

IV. CONCLUSION

Taxpayer and Scott, as owners of all the Watershed timber, started as the potential beneficiaries of all the § 631(a) benefits inhering in such timber. Refining of the issues by long litigation has eliminated Scott as a serious contender and the only question now is whether the accommodation of a public interest somehow caused the § 631(a) benefits to simply disappear with a resulting windfall to the Government.

We ask the Court to observe the absence of distinctions, meaningful in light of the language and policy of § 631(a), between taxpayer's claim and that of the typical § 631(a) claimant. We believe the Government will readily agree that the hiring of a logger, even one also employed by other parties, does not, of itself, preclude § 631(a) benefits. Nor should benefits be lost if an owner acts to safeguard the land and its reforestation by specifically identifying a reputable operator in the contract as did the grantee of the land, Seattle, in the instant case.

The fact that taxpayer's interest in the Watershed timber is an undivided half interest is surely no bar to § 631(a) benefits. It has no consequence except a delay in ascertaining the specific trees that taxpayer ultimately receives. Other taxpayers who make cutting contracts as joint venturers, joint tenants, or tenants-in-common, will be in the same position. So will taxpayers who are required by their contracts to cut "selectively," i.e., are not permitted to "clear cut" and

are thus unable to ascertain in advance of cutting precisely which trees they will receive. Similarly situated are lessees who agree to limit their annual cut to an amount equal to normal growth so that they are unlikely to know precisely which trees will be cut in any year or even which trees will be left at the termination of the lease. See, for example, *Dyal v. Union Bag-Camp Paper Corporation*, 263 F. 2d 387 (5th Cir. 1959).

In short, all distinctions between taxpayer's claim for § 631(a) benefits and more typical claims are revealed as quibbles which cannot stand against (i) taxpayer's unrestricted right to use or dispose of its half of the Watershed timber, (ii) the fact that taxpayer paid a "stumpage" rather than a "log" price, (iii) the fact that the actions of the woodsmen who felled taxpayer's half of the Watershed timber must be imputed to taxpayer under the Commissioner's own rules, (iv) the fact that taxpayer actually earned and paid taxes on the gains giving rise to the benefits taxpayer claims.

Respectfully submitted,

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No. 21834-A

In the

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA, *Cross-Appellant.*

vs.

WEYERHAEUSER COMPANY, *Cross Appellee,*

ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON

ANSWER OF WEYERHAEUSER COMPANY AS CROSS-APPELLEE

DANIEL C. SMITH,
SNYDER J. KING,
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QUESTION PRESENTED

Whether property losses (not insured and, therefore, deductible under § 165 of the Internal Revenue Code of 1954) may be deducted from ordinary income, or are converted to mere capital losses by application of § 1231(a) of the Code.

STATUTE TO BE CONSTRUED

"Sec. 1231. PROPERTY USED IN THE TRADE OR BUSINESS AND INVOLUNTARY CONVERSIONS.

"(a) **General Rule.** — If, during the taxable year, the recognized gains on sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. For purposes of this subsection—

(1) in determining under this subsection whether gains exceed losses, the gains described therein shall be included only if and to the extent taken into account in computing gross income and the losses described therein shall be included only if and to the extent taken into ac-

count in computing taxable income, except that section 1211 shall not apply; and

(2) losses upon the destruction, in whole or in part, theft or seizure, or requisition or condemnation of property used in the trade or business or capital assets held for more than 6 months shall be considered losses from a compulsory or involuntary conversion."

STATEMENT

During the years in issue, 1954, 1955, 1956 and 1957, cross-appellee (hereinafter "taxpayer") suffered losses, caused by various destructive agencies, of property used in its business (R. 4, 21). Because the losses were not insured, taxpayer claimed a deduction from ordinary income under § 165 of the Internal Revenue Code of 1954. On audit, the deductions were not challenged by the Government, but were converted to capital losses (R. 5, 21-22). The Government seeks to justify its action by application of § 1231(a) of the Code. The question thus presented is whether § 1231(a) applies to convert uninsured property losses, allowable as deductions under § 165, from ordinary to capital losses.

ARGUMENT

I

BACKGROUND OF QUESTIONS PRESENTED

The lower court resolved the question presented in favor of taxpayer, i.e., it held that § 1231(a) did not apply to convert taxpayer's uninsured 1954-57 losses of business property from ordinary losses to capital losses (R. 22). In so holding, it followed the *only* cases

squarely in point. *Maurer v. United States,* 284 F.2d 122 (10th Cir. 1960); *Oppenheimer v. United States,* 220 F. Supp. 194 (W.D. Mo. 1963).

After *Maurer* was decided by the Tenth Circuit, the Internal Revenue Service announced that it would not follow it as a precedent. Rev. Rul. 61-54, 1961-1 Cum. Bull. 398. When the issue was again decided for a taxpayer in *Oppenheimer* with express reliance on *Maurer,* the Government declined to appeal, but still would not acquiesce in *Maurer.* The instant case was the third to be decided in favor of a taxpayer and against the Government.

Things might have continued indefinitely in this vein but for the passage of the Technical Amendments Act of 1958, which, in a limited way, came to the Government's rescue. Ironically, the portion of that Act pertinent here, § 49, was intended to benefit taxpayers. It added a sentence to § 1231(a), preventing the application of that section to convert ordinary losses into capital losses *if* (i) the property affected is used in the trade or business or held for production of income, and (ii) the loss occurs during taxable years beginning after December 31, 1957. Subsequent to the amendment, the Government commenced to argue that the failure of the amendment to give relief from § 1231(a) for post-1957 losses to personal property meant that Congress intended such losses to be covered by § 1231(a). While the contention is plausible, and ordinarily would be highly persuasive, it can be argued that under the particular circumstances it includes a non sequitur. When Con-

gress passed the Technical Amendments Act of 1958, it could know only that the Commissioner was then denying relief which the amendment would provide. Congress did not know that the Tenth Circuit would later decide the issue not only in favor of taxpayers suffering losses to income property but in favor of taxpayers suffering losses to other property as well. One may fairly doubt whether, by passing an amendment for relief of taxpayers (suffering losses to income property), Congress intended to hand the Government a weapon for use against other taxpayers (suffering losses to personal property). Nevertheless, the Government's argument that an amendment aiding income property justified a negative inference against personal property met with quick success before the Tax Court. *Chewning v. Commissioner,* 44 T.C. 678 (1965). Later three circuits followed the Tax Court's lead. *Chewning v. Commissioner,* 363 F. 2d 441 (4th Cir. 1966), cert. denied, 385 U.S. 930 (1966); *Morrison v. United States,* 355 F. 2d 218 (6th Cir. 1966), cert. denied, 384 U.S. 986 (1966); *Campbell v. Waggoner,* 370 F. 2d 157 (5th Cir. 1966).

Note, however, that despite the Government's reliance on them *these cases are not in point* for two reasons. First, taxpayer is the first taxpayer litigating this issue to have suffered losses to *income* property. Thus, the negative inference that the Government seeks to draw from the 1958 amendment (i.e., that because it benefits taxpayers with losses to income property, it hurts taxpayers with losses to personal property) is not applicable to taxpayer. Second, this

case, like *Maurer* and *Oppenheimer,* involves years *before* the effective date of the 1958 amendment. The Tax Court, in *Chewning, supra,* considered the latter distinction alone sufficient to distinguish *Maurer* and *Oppenheimer* and expressly declined to pass on the issue there involved.

Nevertheless, the Government has been sufficiently encouraged by the post-1957 cases to appeal this case and try another attack on *Maurer.* In response, we defend the *Maurer* decision, the unappealed *Oppenheimer* decision, and the lower court's decision in the instant case, on four grounds:

(i) The *Maurer* rationale is sound as the only one consistent with the literal mandate of the statute.

(ii) The legislative history supports *Maurer* as applied to the facts of the instant case.

(iii) The post-1957 cases do not undermine *Maurer* as applied to the instant case.

(iv) The Government has argued before the Supreme Court that *Maurer* should be distinguished from the post-1957 cases.

II

THE *MAURER* RATIONALE IS SOUND

A. The *Maurer* Rationale Is in Accord With the Literal Terms of the Statute.

It is undisputed that taxpayer's uninsured property losses are deductible under § 165 of the Internal Revenue Code of 1954. The dispute that exists is whether taxpayer may deduct such losses from ordinary income or merely from capital gain income. We

believe that in resolving this dispute the Court may consider taxpayer and the Government as agreed upon the following:

1. Under the general Code definitions, a loss will be a capital loss only if there is a *sale or an exchange* of a certain type of asset. § 165(f); § 1222 (2) and (4).

2. The property which taxpayer lost through destruction was not sold or exchanged — it was merely lost.

3. Accordingly, under the general Code definitions taxpayer's losses would be deductible from ordinary income.

4. In defense of its position that taxpayer's losses are deductible only from capital gain income, the Government must contend that the first sentence of § 1231(a) applies to require that taxpayer's losses be "considered" as losses from sales or exchanges.

The sole Circuit Court decision applicable to pre-1958 years is *Maurer v. United States, supra,* decided by the Tenth Circuit.

Maurer involved damage to trees and plants and other physical damage to property caused by drought and abnormal weather conditions. Under the jury verdict in the trial court, the losses were deductible under § 165. They were deductible from ordinary income unless § 1231(a) applied. Relying upon both the literal language of that section and its legislative history, the Tenth Circuit concluded that § 1231(a)

did not apply to convert the losses from ordinary losses to mere capital losses.

Section 1231(a) applies to an:

> " . . . involuntary conversion . . . of property . . . into other property or money. . . ." (Emphasis supplied)

As the Tenth Circuit pointed out, it literally applies only to certain assets which have been involuntarily converted "into other property or money." Destroyed property which is insured is, of course, converted into money. But property which is destroyed and not insured is not converted into anything. It is simply lost. Section 1231(a), by its literal terms, does not cover it. Thus, only by ignoring the express provisions of the statute is it possible for the Government to resist the conclusion of the Tenth Circuit.

Note that the Government's reliance on the provision of § 1231(a)(2) that losses upon destruction shall be considered losses from "involuntary conversions" (Govt. Br. 17-18) wholly begs the question. Knowledge that destroyed property has been converted does not answer the question posed by § 1231 (a), "converted into what?" The literal mandate of § 1231(a) relied upon in *Maurer* requires conversion into something specific, i.e., other property or money.

After *Maurer* the pre-1958 loss issue was again considered by a Missouri district court in *Oppenheimer v. United States, supra.* The uncompensated casualty loss involved there resulted from windstorm damage to a residence. The court noted that the Gov-

ernment had announced that it would neither follow *Maurer* nor appeal it and concluded that, unless clearly wrong, *Maurer* should be followed. The Government declined to appeal *Oppenheimer* to the Eighth Circuit.

B. *Maurer* Is Supported by the Legislative History.

The legislative history, relating both to the original enactment of § 1231(a) and its amendment in 1958, supports *Maurer* as applied to the facts of the instant case. In this connection, note that the Government has not claimed support from the legislative history underlying the original enactment of § 1231(a). The Government's legislative history argument (Govt. Br. 19-23) is limited to the 1958 amendment and its own regulations.

The Tenth Circuit pointed out in its review of the legislative history that Congress, when enacting § 1231(a), was focusing on property seized in furterance of the World War II effort. Such seizures were, of course, compensated. It was quite natural, therefore, for Congress to have had in mind compensated conversions when enacting the statute. As the Tenth Circuit reasoned, compensated losses are analogous to a "sale or exchange" for which capital treatment is the general rule. Where, however, the taxpayer receives nothing in return for his property, there is no analogy. Hence, the distinction made by the Court between compensated losses and uninsured losses is supported by general principles as well as the literal language of the statute.

The legislative history of the 1958 amendment to

§ 1231(a) also supports the application of *Maurer* to the facts of the instant case. In its argument to the contrary (Govt. Br. 19-20), the Government has omitted from its brief, and from its reasoning, the most pertinent part of the legislative history relative to the 1958 amendment. Consideration of the omitted history will, we believe, reveal the error in the Government's analysis.

Upon learning in 1958 that the Treasury was including uninsured losses of income property within § 1231(a), thus denying ordinary loss treatment, Congress declared this an "*unintended* hardship!" S. Rep. No. 1983, 85th Cong. 2d Sess., pp. 74-75 (1958-3 Cum. Bull. 922, 995-996). It reversed the Treasury's policy by enacting § 49 of the 1958 Act which precludes application of § 1231(a) to uninsured losses of income property incurred in 1958 and subsequent years.

Specifically, Congress was concerned by the Treasury's discrimination against self-insured businessmen. A self-insured businessman pays his premiums, in effect, by absorbing losses. He gambles that the losses he must absorb will compare favorably with the cost of premiums. Congress could see no reason why a businessman paying his premiums in this fashion should not be treated the same as the businessman who pays premiums on a policy of insurance. Yet the policyholder can deduct his premiums from ordinary income, while the Treasury, by its application of § 1231(a), denied the same right to the self-insured businessman who happened to realize § 1231(a) gains in the same year he suffered the casualty loss. Con-

gress put an end to this "unintended hardship" by enacting the 1958 law, explaining:

> "Where a taxpayer elects to be a self-insurer against casualty losses, there seldom is a conversion into money or other property, as there would be if the destroyed property were insured. If this casualty loss were the only loss incurred during the taxable year by the self-insured person, he would be entitled to the full benefit of an ordinary loss deduction under section 1231, but where there are also 1231 gains, the casualty loss is partially or wholly offset against these gains which would otherwise be taxed as capital gains. As a result, the benefit of having casualty losses treated as ordinary, rather than capital, losses may be reduced or eliminated in the case of self-insurers, depending on the fortuitous circumstance as to what gains the taxpayer may have from trade or business assets or involuntary conversions. This is not a problem for those who are fully insured by others because they receive insurance payments in the case of destroyed property which offset the casualty losses which would otherwise be realized. Moreover, such persons may deduct currently the cost of their insurance for property used in a trade or business. Thus, in their case they obtain a deduction against ordinary income for any premiums paid and any gains from trade or business assets (or involuntary conversions) are taxed as capital gains and are not offset against losses (since these are covered by insurance) which would otherwise be treated as ordinary losses.
>
> "Your committee believes that this constitutes an *unintended hardship* and for that reason it has added a provision to the House bill amending section 1231(a) of the code. . . ." (Emphasis supplied) S. Rep. No. 1983, 85th Cong., 2d Sess., pp. 74-75 (1958-3 Cum. Bull. 922, 995-996).

Subsequently, in *Maurer,* the Tenth Circuit construed the original § 1231(a) language, applying it to a year prior to the effective date of the 1958 Act. Its decision reveals that the hardship was indeed "unintended." The Tenth Circuit found no warrant in the original § 1231(a) language for the Treasury's imposition of the hardship. Its decision results in the treatment "intended" by Congress, namely that the self-insured businessman may deduct his costs against ordinary income just as the insurance policyholder may. That is the result which the taxpayer contends for here. Thus, taxpayer's position is precisely in accord with *Maurer,* the 1958 Act, and the result Congress has indicated was "intended" under § 1231 (a). The Government attempts to impose here the exact tax treatment which Congress labeled as an unintended hardship.

The legislative history quoted in the Government's brief omits the declaration that the Treasury's inclusion of losses to business property within § 1231 (a) was an "unintended hardship." While the Congress could not know, in 1958, that the Treasury's imposition of the hardship would be reversed two years later by the Tenth Circuit in *Maurer,* it is apparent that Congress was quite clear as to the result it "intended" respecting business property in the original enactment of § 1231(a).[1]

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[1]The Government may attack *Maurer* as guilty of over-kill, because it also allows a deduction against ordinary income for losses to personal property, whereas the 1958 Act does not. The Government may argue that the result is discriminatory against policyholders, since premiums for personal property are nondeductible. The distinction does exist, but it

The Government attempts to buttress its legislative history argument with reliance upon its own regulations which the Government lauds as having weathered the storms of statutory amendments and reenactments since 1943 (Govt. Br. 20-23). Note that the regulations, *as the Government interprets them,* are flatly contrary to the literal provisions of the statute. Whereas § 1231(a) literally requires an ". . . involuntary conversion . . . of property . . . into other property or money . . . ," the regulations add *"whether or not* there is a conversion of property into other property or money" (Emphasis supplied). Obviously, the Treasury's "whether or not" clause is its own invention. The Tenth Circuit, in *Maurer,* politely refrained from invalidating the clause by giving it the benefit of every doubt and construing it (contrary to the Government's construction of it here) as consistent with the statute.

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was purposely created by Congress itself, not by *Maurer*. Section 165 (c)(3) allows individual taxpayers a deduction for casualty losses to personal property. There is no similar deduction for premiums paid for casualty insurance on such property nor for other personal losses. Congress has simply been more solicitous of improvident taxpayers who fail to insure against casualty losses than it has been of their more prudent fellow citizens. All *Maurer* could decide was a question of degree (i.e., whether the deduction benefit should be capital or ordinary). *The distinction persists even under the* 1958 *Technical Amendments Act and will continue as long as* § 165 (c) (3) *is part of the Code.* The only issue under the 1958 Act is the degree to which the distinction will persist. It will persist unmitigated in the case of uninsured taxpayers who have no § 1231(a) *gains* in the year of their casualty loss. Only with respect to taxpayers who have such gains does the 1958 Act, under the *Chewning*, *Morrison* and *Waggoner* decisions, *supra*, reduce the degree of difference in treatment. The point here is that, with respect to *business* property, *Maurer* avoided the "unintended hardship" the Treasury sought to impose, and nothing has occurred in the area of personal property to undermine *Maurer's* soundness in the business area.

In any event, it is apparent that the Treasury's interpretation survived until 1958 only because Congress was not aware of it. The absolute lack of any cases on the uninsured casualty loss issue prior to 1960, and the plethora of cases commencing in 1960, reveals that the Treasury did not raise the issue (and thus call it to the attention of Congress) until the late 1950's. Congress thereupon promptly reversed the Treasury's position with respect to income property. The Government's reliance upon its own regulations is thus unwarranted under the circumstances.

C. The Decisions in the Post-1957 Cases Do Not Undermine *Maurer* as Applied to the Instant Case.

The *Chewning, Morrison* and *Waggoner* cases, *supra,* construing the 1958 Technical Amendments Act, and relied upon by the Government (Govt. Br. 23-25) are not in point with the instant case. Their rationale is that, because the 1958 Act was intended to give relief for post-1957 losses to income property, an inference may be drawn against taxpayers who incurred *post*-1957 losses to personal property. Clearly, the same inference is not justified against taxpayers incurring *pre*-1958 losses to *income* property.

The Tax Court was extremely careful not to extend the inference outside the years covered by the 1958 Act. It said in *Chewning* (p. 685):

> ". . . However, we express no opinion as to the correctness of the *Maurer* case, since, unlike the instant case, it involved a casualty loss suffered in a year prior to the effective date of the amend-

ment of Section 1231 by the Technical Amendments Act of 1958. . . .

"The petitioners also cite *Oppenheimer v. United States,* (W.D. Mo.) 222 [sic] F. Supp. 194, in support of their contention. We consider such case inapposite since it also involved a casualty loss suffered in a year prior to the effective date of the amendment made to Section 1231 by the Technical Amendments Act of 1958."

After noting the *Maurer* case and the Tax Court decision in *Chewning,* the Sixth Circuit, in deciding *Morrison,* said (p. 222):

"We realize that the question presented on this appeal is a close one and while we have great respect for the opinion of the Tenth Circuit, we believe that the view we take is the more logical one and that it conforms to the intent of Congress in enacting the legislation."

Out of context, this statement can be read to be critical of *Maurer*. In the context of the holding in *Morrison,* however, it merely says that *Maurer* is not sufficiently strong to overcome the negative inferences drawn from the 1958 Technical Amendments Act respecting losses to *personal* property for *post*-1957 years. The opinion contains nothing critical of *Maurer* as applied to pre-1958 years.[2]

Later, the Fourth Circuit affirmed the Tax Court's decision in *Chewning*. It said (at p. 441):

"We are persuaded by the able opinion of Judge Atkins that the Tax Court was correct in its interpretation of the Code and that we must reject the reasoning of *Maurer v. United States,* 284

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[2]In *Hall v. United States*, 66-2 USTC Par. 74, and *Killebrew v. United States*, 66-2 USTC Par. 75, both decided August 3, 1966, the Sixth Circuit merely adopted its decision in *Morrison*.

F.2d 122 (10th Cir. 1960) in favor of that of *Morrison v. United States*, 355 F.2d 218 (6th Cir. 1966). *While the taxpayers' position was not without some basis in the language of section 1231 prior to the 1958 amendment (Maurer applied the statute as it existed before the amendment), we think that amendment clearly indicated Congress' intention that the taxpayers' loss should not be excluded from treatment under section 1231.* The judgment of the Tax Court is therefore Affirmed." (Emphasis supplied)

While the Fourth Circuit's first sentence seems to reject the reasoning of *Maurer,* the second sentence makes it clear that the rejection pertains only to post-1957 years. Further, of course, the rejection would not pertain to business property, since only personal property was involved in *Chewning.*

At first blush, dicta in the Fifth Circuit's opinion in *Waggoner* appears to support the Government's position in the instant case. In disregard of the fact that it had before it only losses to personal property incurred in a year after the effective date of the 1958 Act, that court made the following sweeping statement (at pp. 159-160):

> "The legislative history of the enactment of the Internal Revenue Code and subsequent amendments does not support the *Maurer* decision, as evidenced particularly by the amendment to Section 1231(a) which was added by Section 49 of the Technical Amendments Act of 1958 (72 Stat. 1642). By this amendment Congress made it clear that prior thereto all wholly uncompensated casualty and theft losses were covered by Section 1231."

The rest of the opinion, however, makes it clear that

although it expressed an opinion as to *pre-1958* years which were not before it, the Fifth Circuit's dicta should be given no weight in a case involving *income property*:

(i) First, the Court's opinion immediately makes it clear that, despite its sweeping statement, it was focusing on *personal* property. As its first argument in support of the statement, it said (at p. 160):

> "The 1958 amendment had the effect of excluding from Section 1231 treatment only wholly uncompensated casualty and theft losses used in the trade or business and of any capital asset held for more than six months and held for the production of income. Congress thus unmistakably showed that it did not wish to exclude from the effect of Section 1231 wholly uncompensated casualty and theft losses on property *not* used in a business or *not* held for the production of income, and the legislative history so reflects." (Emphasis by the Court)

(ii) Second, it seems that the Fifth Circuit did not know that the Treasury's denial of ordinary loss treatment for losses to *business property* was considered by Congress to be an "unintended hardship." The Government's brief before the Fifth Circuit (and before all the other circuits as well), in its extensive treatment of the legislative history, omits the "unintended hardship" language. The Fifth Circuit, in turn, simply incorporated the Government's quotation from the legislative history bodily into its opinion (n. 3, p. 160) with exactly the same omissions and even the same italics. The

Fifth Circuit was thus apparently entirely unaware that Congress considered the Treasury's discrimination against self-insured businessmen as "unintended," and that *Maurer* served to prevent the "unintended hardship."

(iii) Finally, the Fifth Circuit's reliance upon the Treasury's regulations provides a third reason for giving its dicta no weight in a case involving losses to income property. The Court said (at p. 161):

> ". . . Important also is the consistent maintenance of the Treasury's view over a period of twenty-two years, as shown by its regulations since 1943, which Congress has not seen fit to change."

The Court's reference to regulations "unchanged" clearly indicates its focus on losses to *personal* property, because the 1958 Technical Amendments Act had, by the time of *Waggoner,* reversed the Treasury's position respecting losses to *income* property.

The Government concludes its affirmative argument based on case law with two brief arguments (numbered 1 and 2, Govt. Br. 26-27) which are essentially a restatement of its earlier contention (Govt. Br. 19-20) that Congress, when amending § 1231(a) in 1958, assumed that its original meaning was the same as that proclaimed by the Government in this case. We have already pointed out that in 1958 Congress was confronted with the practical problem of dealing with a Treasury administrative practice which Congress believed imposed an "unintended hardship."

For all practical purposes affecting the welfare of taxpayers, the statute then meant what the Treasury said it meant. Neither the Congress nor taxpayers could then know that the Tenth Circuit would soon declare the hardship imposed by the Treasury as "unintended."

D. The Soundness of *Maurer* Is Indicated by the Weakness of the Government's Attacks on It.

The Government has not attacked the *Maurer* rationale head-on. It has not directly responded to the Tenth Circuit's reasoning (i.e., that a statute which literally requires a conversion "into other property or money" should not be applied in a case where property is simply lost and no other property or money received to replace it).

Rather, the Government's attack, while ingenious, is of an indirect or collateral nature. It separates expressions used by the Tenth Circuit from the context of its whole rationale and attacks the isolated expressions one by one. The Government thereby claims to find in them erroneous concepts and non sequiturs. It seeks to undermine this Court's confidence in the Tenth Circuit's general grasp of the Internal Revenue Code without really coming to grips with the Tenth Circuit's theory. A brief consideration of the Government's six arguments (Govt. Br. 27-36) should suffice to show that the alleged errors and non sequiturs simply reflect misconstructions of the Tenth Circuit's language resulting from its consideration in isolation from context.

1. The Government's principal attack (Govt. Br. 27-29) is made upon the Tenth Circuit's statement that §§ 165 and 1231(a) are "mutually exclusive." The Government correctly points out that § 165 provides the essential authorization for deduction of losses. Therefore, it must apply to the loss whether or not § 1231(a) applies. Section 1231(a), if it applies, merely determines the character of the losses (i.e., whether capital or ordinary). In this sense, § 165 and § 1231(a) work together and are not mutually exclusive. However, the issue in *Maurer* was not deductibility, but solely the *character* of the loss. When § 1231(a) applies, it *exclusively* determines the character of the loss. When §1231(a) does not apply, the field is left exclusively to § 165. Thus, in determining the *character* of loss, as in *Maurer,* these sections do not operate together and may correctly be said to be mutually exclusive. Accordingly, there is no good reason to assume that the Tenth Circuit misconceived the relationship between them. Strong evidence that it did not misconceive the relationship is the fact that it properly reasoned to its conclusion about the character of the loss by construing the language and legislative history of § *1231(a).* It did not construe § 165 and conclude that its applicability excluded the applicability of § 1231(a). As a result, even if we were to assume, *arguendo,* that the Tenth Circuit misconceived the §§ 165-1231(a) relationship, the misconception would be irrelevant, since it is patently clear from its opinion that the Tenth Circuit ar-

rived at its decision in *Maurer* by construing the language and legislative history of the proper statute, § 1231(a).

2. The Government's second, third and fourth attacks (Govt. Br. 30-35) are directed against expressions from the context of the Tenth Circuit's reasoning about the legislative history of § 1231(a). The Tenth Circuit reasoned that the literal requisite for applying § 1231(a) (that there be an involuntary conversion of property "into other property or money") is supported by the legislative history, which indicates that when enacting § 1231(a), Congress had in mind property seized in furtherance of the World War II effort. Since such seizures were compensated, it was natural for Congress to have addressed itself to compensated seizures, and these are analogous (or, in the Tenth Circuit's language, "contextually similar" or "closely akin") to a sale or exchange for which capital treatment is the general rule. Where, however, the taxpayer receives nothing in return for his property, there is no analogy to a sale or exchange and, consequently, a lack of support for application of § 1231(a). The Government has seized upon short expressions employed by the Tenth Circuit in the course of such reasoning and used them, in its second and third attacks (Govt. Br. 30-31) to support the argument it made in the first attack (about the §§ 165-1231(a) relationship), which we dealt with above and will not further belabor. In its fourth attack (Govt. Br. 31-35), the Government reproaches the Tenth Cir-

cuit for such expressions as "contextually similar" and "a compensated loss is a taxable event closely akin to a sale or exchange." The Government proceeds with the argument as if the Tenth Circuit's conclusion "rested upon a erroneous assumption . . . that § 1231 capital loss treatment may apply only where there is a sale or exchange" (Govt. Br. 32). This is another misconstruction of the Tenth Circuit's meaning. The Tenth Circuit, in fact, relied upon the literal language of § 1231(a) requiring a conversion into "other property or money." It analogized a compensated loss to a sale or exchange only to show that Congress' use of the "other property or money" language was probably intentional and not inadvertent. Thus, the Government's attack suffers from the defect of considering isolated expressions out of context and treating them as if they were employed to prove much more than the Tenth Circuit actually employed them to prove.

The Government's fifth attack (Govt. Br. 35) is again essentially a repetition of its first. Its sixth, and last argument (Govt. Br. 35-36) simply chides the Tenth Circuit for not being persuaded by the Government's argument based on its regulations.

It can be seen that the essential characteristic of all the Government's attacks on the Tenth Circuit's rationale is a failure to meet the rationale head-on, i.e. a failure to face the Tenth Circuit's recognition that property destroyed without compensation is simply lost and therefore not converted "into other property or money" as the statute expressly requires.

III

THE GOVERNMENT HAS ARGUED BEFORE THE SUPREME COURT THAT *MAURER* IS DISTINGUISHABLE FROM THE POST-1957 CASES

In addition to distinguishing the instant case because it involves income property, we have argued that this case, like *Maurer*, is distinguishable from the post-1957 cases because it involves years prior to the effective date of the 1958 Act. The Government concedes that it has made the same argument before the Supreme Court (Govt. Br. 25). Its exact words in a memorandum in opposition to the taxpayer's petition for certiorari in *Chewning v. Commissioner, supra,* were (pp. 3-4):

> "Petitioner argues that the instant decision conflicts with *Maurer v. United States,* 284 F.2d 122 (C.A. 10). However, that case involved a pre-1958 casualty loss. Therefore, the language of the statute at the time of the transaction involved in *Maurer* was materially different from the statute here in question. There is no conflict among the courts of appeals as to the meaning of § 1231 as amended in 1958."

Notice that the Government did not say that *Maurer* was wrong. It simply distinguished it. To distinguish cases is to say that each can be correct notwithstanding the other. Having told the Supreme Court that *Maurer* is distinguishable from the later cases, the Government should not now be heard to say to the contrary.

Respectfully submitted,

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CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated this 28th day of February, 1968.

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John T. Piper, Attorney.